



**BILLING CODE: 8070-01-P**

## **FEDERAL HOUSING FINANCE AGENCY**

**[No. 2020–N–1]**

### **Property Assessed Clean Energy (PACE) Program**

**AGENCY:** Federal Housing Finance Agency.

**ACTION:** Notice and Request for Input.

**SUMMARY:** The Federal Housing Finance Agency (FHFA), as regulator for Fannie Mae and Freddie Mac as well as the Federal Home Loan Banks, seeks public input on residential energy retrofitting programs financed through special state legislation enabling a “super-priority lien” over existing and subsequent first mortgages. In particular, FHFA seeks input on potential changes to its policies for its regulated entities based on safety and soundness concerns. These state programs, termed Property Assessed Clean Energy or PACE, address residential properties and commercial applications. FHFA’s primary focus is on residential PACE programs in this Request for Input (RFI).

**DATES:** Written input must be received by [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

**ADDRESSES:** You may submit your response on the Notice identified by “PACE Request for Input, Notice No. 2020–N–1,” by any one of the following methods:

- *Agency Website:* [www.fhfa.gov/open-for-comment-or-input](http://www.fhfa.gov/open-for-comment-or-input).
- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting input. If you submit your response to the Federal

eRulemaking Portal, please also send it by email to FHFA at [RegComments@fhfa.gov](mailto:RegComments@fhfa.gov) to ensure timely receipt by the agency.

- *Mail/Hand Delivery:* Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street SW, Washington, DC 20219, ATTENTION: “PACE Request for Input, Notice No. 2020–N–1.”

FHFA will post all public responses received without change, including any personal information you provide, such as your name and address, email address, and telephone number, on the FHFA website at <http://www.fhfa.gov>. In addition, copies of all responses received will be available for examination by the public through the electronic docket for this Notice also located on the FHFA website.

**FOR FURTHER INFORMATION CONTACT:** Alfred M. Pollard, General Counsel, [Alfred.Pollard@fhfa.gov](mailto:Alfred.Pollard@fhfa.gov), (202) 649-3050 (this is not a toll-free number), Federal Housing Finance Agency, 400 Seventh Street SW, Washington, DC 20219. The Telecommunications Device for the Deaf is (800) 877–8339.

## **SUPPLEMENTARY INFORMATION:**

### **Request for Input**

#### *A. PACE Programs*

The Federal Housing Finance Agency (FHFA), as regulator for Fannie Mae and Freddie Mac (the Enterprises) as well as the Federal Home Loan Banks, seeks public input on residential energy retrofitting programs financed through special state legislation enabling a “super- priority lien” over existing and subsequent first mortgages. In particular, FHFA seeks input on potential changes to its policies for its regulated entities based on safety and soundness concerns. These state programs, termed Property

Assessed Clean Energy or PACE, address residential properties and commercial applications. FHFA's primary focus is on residential PACE programs in this Request for Input (RFI).

These state initiatives authorize counties, municipalities and other government entities to create a financing scheme with, in the majority of cases, private parties administering the home energy retrofit programs. The programs lend to consumers for defined products and services and approved contractors. To attract private capital, the loans impose a tax assessment on the property so that the loan is repaid under a locality's taxing structure to the benefit of bond holders or lenders. This assures priority status over any first lien mortgage at any tax sale or foreclosure sale. PACE is not traditional second mortgage or home equity lending.

Each PACE lending program was created to attract private investors to provide funds for loans for energy retrofits. Unlike normal secured home improvement financing, the PACE program seeks to secure a super-priority first lien over all other lien holders on a property through a governmental property tax lien. As the financing concept provides that the lien, associated with the PACE loan, "runs" with the property, this proves attractive to investors who provide PACE program funding. With a super-priority lien position, the risk of investor loss becomes very small as that lien has priority over pre-existing first mortgages and has the possibility of continuing to run with the property to a subsequent purchaser. This investor opportunity comes at the expense of existing lien holders, who have not had the ability to consent or not consent to the new lien and unexpectedly bear a new risk of loss that did not exist at the time the mortgage was originated.

As a tax-related assessment, the PACE loan is fundamentally asset-based lending that “runs with the land.” This means a purchaser of a home with an existing PACE loan assumes the outstanding obligation and any unpaid or delinquent amounts. Despite the benefit of highest priority lien position, interest rates charged to borrowers for PACE are typically substantially higher than for a first-lien mortgage. Purchasers may not wish to acquire such obligations where the PACE interest rate is higher than their purchase loan rate or the improvements are out of date or in need of repair. State laws provide for localities to collect administrative fees of up to 10 percent of the loan amount usually added to the loan amount, and for lending amounts tied not to borrower’s “ability to repay,” but to the property and its assessment up to 15 percent of the assessed value. The holder of such a lien may move for foreclosure on the property or the tax administrator may do so and recover the unpaid amount of the PACE loan; other parties recover what remains.

Such loans are not recorded in local land records but in tax records and may bear a denomination other than PACE such as an abbreviated PACE program name. Such tax records usually list the amount of the loan and the amount paid, but do not provide distinctions on principal and interest. They are not part of ordinary mortgage record searches.

Some PACE programs claim that PACE loans do not affect debt-to-income (DTI) ratios, an important benchmark for consumers and lenders. The Enterprises require lenders to include homeowner property tax payments that would include PACE assessments as a component of the loan applicant’s present or future housing expense to calculate DTI for loan eligibility. Unavailable data on DTI may permit a homeowner to

incur more debt with lenders unaware of the PACE obligation due to a lack of DTI information or potentially inaccurate credit scores. Because PACE loans are not recorded in land records but in tax rolls, often with varying names or descriptions, they are difficult to identify in title searches.

Finally, PACE programs lack uniformity and may differ in every community within a state, making it challenging for lenders to evaluate the implications for individual homeowners or home purchasers.

*B. FHFA, Financial Regulators and Super-Priority Liens*

In 2010, FHFA, the Office of the Comptroller of the Currency (OCC), the National Credit Union Administration and the Federal Deposit Insurance Corporation highlighted the risks attendant to PACE lending.<sup>1</sup> Fundamentally, the priming of a first mortgage was and remains the central issue. FHFA directed Fannie Mae and Freddie Mac not to purchase or re-finance mortgages with PACE liens and reserved other potential actions. The Federal Home Loan Banks were alerted to the need for vigilance in accepting collateral for advances that may have PACE liens attached. FHFA determinations regarding residential PACE loan programs have been upheld in three Circuit Court decisions.<sup>2</sup>

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<sup>1</sup> For example, in OCC's Supervisory Guidance, OCC 2010-25 (July 6, 2010) at <https://www.occ.gov/news-issuances/bulletins/2010/bulletin-2010-25.html>, the OCC emphasized that beside loans, banks investing in mortgage backed securities should take into account PACE programs in their asset valuations and to consider the impact of PACE programs on their institutions and the markets when making any decision on "associated bond underwriting." Overall, OCC indicated it considered programs that failed to "observe existing lien preference" to pose "significant regulatory and safety and soundness concerns."

<sup>2</sup> See County of Sonoma v. FHFA, 710 F.3d 987 (9<sup>th</sup> Cir. 2013); Leon County v. FHFA, 700 F.3d 1273 (11<sup>th</sup> Cir. 2012); and Town of Babylon v. FHFA, 699 F.3d 221 (2<sup>nd</sup> Cir. 2012) (appeal of consolidated cases, after granting of motions to dismiss in the Southern and Eastern Districts of New York).

In 2014, FHFA re-stated its concerns regarding PACE and other “lien-priming” programs.<sup>3</sup> In its public statement of December 22, 2014, FHFA summarized that—

The existence of these super-priority liens increases the risk of losses to taxpayers. Fannie Mae and Freddie Mac, while operating in conservatorship, currently support the housing finance market by purchasing, guaranteeing, and securitizing single-family mortgages. One of the bedrock principles in this process is that the mortgages supported by Fannie Mae and Freddie Mac must remain in first-lien position, meaning that they have first priority in receiving the proceeds from selling a house in foreclosure. As a result, any lien from a loan added after origination should not be able to jump in line ahead of a Fannie Mae or Freddie Mac mortgage to collect the proceeds of the sale of a foreclosed property.

Enterprise programs support the ability of a borrower to purchase a home and the Enterprise mortgage is recorded in first-lien position. A PACE loan is only available to someone who owns a home. In the vast majority of cases, home ownership is obtained by a mortgage loan in which a lender has placed a substantial amount of capital at risk. For the Enterprises, this means up to \$510,400 or, in high cost areas, up to \$765,600 to provide homeownership opportunities. Accordingly, the Enterprises require that the mortgage loans they purchase remain in a first-lien position for the life of the loan.<sup>4</sup> Also, the congressional charters for the Enterprises require borrowers to have at least 20 percent equity in a home or an approved form of credit enhancement, such as mortgage insurance, to address the risk of nonpayment. A municipality providing “super-priority” lien status for a PACE loan can erode— partially or completely— that 20 percent equity cushion, as required by statute, and place either the homeowner or a regulated entity, or both, at substantial risk.

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<sup>3</sup> <https://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-of-the-Federal-Housing-Finance-Agency-on-Certain-Super-Priority-Liens.aspx>

<sup>4</sup> Enterprise loans are packaged into mortgage backed securities and purchased by investors which supports housing finance; investors rely on the underlying loan pool in making their purchases.

PACE programs present a threat to the quality and stability of large amounts of Enterprise loans. According to Fannie Mae and Freddie Mac, in mid-2019 in California and Florida, the two most active residential PACE jurisdictions, the Enterprises had over 5.4 million loans with unpaid principal balances of approximately \$1.18 trillion. These bear a risk of impairment by super-priority PACE loans that the Enterprises clearly stated in their loan instruments must be avoided. Further, these loans, that “run with the land,” impair the foreclosure process when that is an unavoidable outcome to the benefit of PACE investors.

Consumer issues have surrounded the PACE programs from their inception. These include the cost of funding, contractor sales techniques (notably, responding to a limited homeowner problem and marketing a full house retrofit), rolling the administrative fees for the county into the PACE loan amount, product sales at above market interest rates, workmanship issues, inadequate disclosures and indiscriminate lending regardless of ability to repay.<sup>5</sup> Consumer protections at the state level for PACE lending are uneven and in some instances non-existent. Multiple reports exist of pressure on homeowners with PACE liens to pay off the PACE loans in order to sell their homes, either to permit the purchaser to secure financing or because the purchaser does not want to be saddled with a loan with an interest rate that can be double the rate of a new

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<sup>5</sup> California enacted into law AB 1284 (California Financing Law) in 2017. The California Department of Business Oversight offered two opportunities for public input in November 30, 2017 and April 19, 2018 regarding its rulemaking under the law for licensure, program administration, consumer related provisions and cost benefit analysis of its rules. See <http://www.dbo.ca.gov/Licensees/PACE/>.

Materials presented to the legislature and to the California Department of Business Operations provide significant information of consumer problems relating to PACE, including descriptions of individual consumer issues with PACE administrators and their contractors and with the impact on selling their homes. As well, information on the effectiveness of individual products and how quickly homeowners receive benefits in excess of the loan payments (on higher cost loans) have been questioned and led to federal legislation on disclosure requirements. Additionally, real estate professionals have commented on the problems of selling homes with PACE liens.

mortgage.<sup>6</sup> Borrower demands for pay offs have occurred independent of positions taken by FHFA.

Recognizing consumer issues, Congress in 2018 enacted amendments to the Truth in Lending Act to require federal regulation when PACE loans are made to assure more effective consumer protections, focused on ability to repay requirements. The law did not mandate that such properties impacted by such loans serve as collateral for mortgage loans made, purchased or authorized by any primary or secondary market participant. The Consumer Financial Protection Bureau was entrusted with implementing this law by regulation.<sup>7</sup>

### *C. Financing Energy Retrofitting*

FHFA and other federal regulators support financing for residential energy retrofitting, where appropriate, and, in many instances, that an actual consumer benefit exists as documented by an energy saving report. Such lending, by regulated financial institutions, is undertaken with strict attention to ability to repay rules, safety and soundness prescriptions and other elements of the robust range of federal and state consumer protection provisions. Properly underwritten loans provide sustainable interest rates, consider the financial position of a homeowner and provide mortgage makers and mortgage investors a reliable product for purchase. At the same time PACE financing

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<sup>6</sup> *Id.* Consumer advocacy groups have highlighted, along with repeated newspaper reports, that this dilemma exists for homeowners with PACE liens. Consumer complaints involving PACE loans on a range of complaints have been detailed; *see*, for example, National Consumer Law Center, *Residential Property Assessed Clean Energy Loans: The Perils of Easy Money for Clean Energy Improvements* (September 2017), pp. 5-17.

<sup>7</sup> PL 115-174 (2018), section 307; codified at 15 U.S.C. 1639c(b)(3)(C). Also, Bureau of Consumer Financial Protection, Advance Notice of Proposed Rulemaking on Residential Property Assessed Clean Energy Financing, 84 FR 8479 (March 8, 2019).



encumbers the foreclosure process with an obligation that “runs with the land” where normal foreclosure ends claims against the property.

The Department of Housing and Urban Development (HUD) has taken initial steps to address some of the same concerns described above. On December 7, 2017, HUD issued a Mortgagee Letter announcing that the Federal Housing Administration (FHA) will no longer insure new mortgages on properties that include PACE assessments, citing concerns about the potential for increased losses to the Mutual Mortgage Insurance Fund (MMI Fund) due to the priority lien status given to such assessments.<sup>8</sup>

Despite restricting FHA insurance for properties already encumbered by PACE assessments, nothing prevents a FHA-insured borrower from acquiring a PACE loan in the future. HUD considers PACE assessments as potentially dangerous to the MMI Fund and, further, placing these assessments on FHA-insured properties post-endorsement creates a lack of transparency making it difficult for the agency to understand the true nature of the risks involved.<sup>9</sup> HUD has indicated that it is unknown how many existing FHA borrowers have taken out PACE loans and has expressed concern that FHA is not in a first lien position.<sup>10</sup> Allowing PACE assessments to essentially subordinate the FHA-insured mortgage creates a default under the mortgage and is particularly problematic for HUD and FHA as the MMI Fund is exposed to unmeasurable risk.

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<sup>8</sup> U.S. Dep’t of Hous. and Urban Dev., Mortgagee Letter 2017-18 (Dec. 7, 2017).

<sup>9</sup> Press Release, U.S. Dep’t of Hous. and Urban Dev., FHA to Halt Insuring Mortgages on Homes with PACE Assessments (Dec. 7, 2017) <https://archives.hud.gov/news/2017/pr17-111.cfm>.

<sup>10</sup> *An Examination of the Federal Housing Administration and Its Impact on Homeownership in America: Hearing Before the Subcomm. on Hous., Cmty Dev., and Ins. Of the H. Comm. on Fin. Serv.*, 116th Cong. (Dec. 5, 2019).

#### *D. Actions by the Federal Housing Finance Agency*

The continuation of PACE programs and their adverse impact merits review for potential modification by FHFA of its safety and soundness and prudential standard directions to its regulated entities.

In its 2010 statement on PACE programs and in its directions to Fannie Mae and Freddie Mac, FHFA indicated that the Enterprises could undertake certain actions, including but not limited to, adjusting loan-to-value ratios to reflect the maximum permissible PACE loan amounts available to borrowers in jurisdictions with PACE program, requiring in loan agreements that a PACE loan may only be made in relation to an Enterprise purchased mortgage with the consent of the Enterprise, tightening debt-to-income ratios to account for additional borrower obligations associated with PACE loans and such other actions as would be appropriate. The Federal Home Loan Banks were advised to consider their acceptance of collateral that might be affected by PACE loans as a prudent safety and soundness practice.

The most direct action taken was by the Enterprises issuing bulletins and updates to their seller-servicer guides to indicate the Enterprises would not make or refinance a mortgage loan for a property encumbered by a PACE lien.<sup>11</sup> This Request for Input asks

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<sup>11</sup> Fannie Mae Selling Guide (May 1, 2019), Lender Letter (September 18, 2009), and announcements (February 27, 2018; December 1, 2010; August 31, 2010):  
<https://www.fanniemae.com/content/guide/selling/b5/3.4/01.html>  
<https://www.fanniemae.com/content/announcement/110709.pdf>  
<https://www.fanniemae.com/content/announcement/sel1802.pdf>  
<https://www.fanniemae.com/content/announcement/sel1016.pdf>  
<https://www.fanniemae.com/content/announcement/sel1012.pdf>

Freddie Mac Single-Family Seller/Servicer Guide (May 1, 2019), Freddie Mac Single-Family Refinancing and Energy Retrofit Programs page, Selling Guide Bulletin (August 24, 2016), Lender Letter (August 20, 2014):  
<https://guide.freddiemac.com/app/guide/section/4301.4>  
<https://sf.freddiemac.com/general/refinancing-and-energy-retrofit-programs>  
<https://guide.freddiemac.com/app/guide/bulletin/2016-16>

for public comment on enhancing the actions to be taken regarding PACE liens in light of their continued threat to first lien mortgages and to homeowners and home purchasers from the lien priming effects of PACE loans.<sup>12</sup> Such actions are founded on FHFA's regulatory authorities relating to safety and soundness and the prudential authorities enunciated in the Housing and Economic Recovery Act of 2008.<sup>13</sup>

FHFA, therefore, asks for public input on the following questions:

1. Should FHFA direct the Enterprises to decrease loan-to-value ratios for all new loan purchases in states or in communities where PACE loans are available? By how much should available loan-to-value ratios be reduced to address the increased risk of such liens being placed on the property and what related implications would result from such actions? Should loan-to-value (LTV) ratios be reduced for all loan purchases sufficient to take into account the maximum amount of a PACE financing available in that community? Should potential future increases in permitted percentage of available PACE financing-to-assessed value be considered?

2. Should FHFA direct the Enterprises to increase their Loan Level Price Adjustments (LLPAs) or require other credit enhancements for mortgage loans or re-financings in communities with available PACE financing? What increased levels would

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<sup>12</sup> In certain related cases, focused mainly but not exclusively on conservatorship authorities, courts have made clear that both Enterprise guides and actions by FHFA regarding PACE are appropriate and preemptive of state authorities, including state taxing authorities. *See e.g.*, *Berezovsky v. Moniz*, 869 F.3d 923 (9<sup>th</sup> Cir. 201) (HOA priority liens); *FHFA v. City of Chicago*, 962 F.Supp.2d 1044 (N.D.Ill. 2013)(local regulation of property maintenance preempted by FHFA action under HERA); and *Commonwealth of Mass. v. FHFA*, 54 F.Supp.3d 94 (D.Mass. 2014)(even if conservatorship not in place, court ruled that federal law preempts state law that are in "irreconcilable conflict" with federal statute and that applied to state housing statute at issue in case).

<sup>13</sup> 12 U.S.C. 4513b provides FHFA should establish for its regulated entities, by regulation or guidelines, standards related *inter alia* to management of market risk and credit risk, management of asset growth and such other operational and management standards as the Director determines to be appropriate.

be appropriate for such LLPAs in light of the risks of PACE financing posed to the Enterprises?

3. Should FHFA consider other actions regarding Enterprise purchase or servicing requirements in jurisdictions with PACE programs?

4. Should FHFA establish safety and soundness standards for the Federal Home Loan Banks to accept as eligible advance collateral mortgage loans in communities where PACE loans are available? How might those standards best address the increased risk of such collateral? Should such standards be in line with actions that FHFA would undertake for the Enterprises, recognizing the difference in business structures between the Enterprises and the Banks?

5. How might the Enterprises best gather or receive information on their existing guaranteed or owned mortgage loan portfolios to understand which loans have PACE liens and in what amount? Should mortgage loan servicers be required to gather and report such information to the Enterprises on a periodic basis? What would the costs and implications be of such a requirement?

6. Would it be most effective for states that authorize PACE programs to require a registry of PACE lending so that information currently only held by PACE vendors or local tax rolls could be available and maintained on an ongoing basis?<sup>14</sup> What data should be included in such a registry? What access would be permitted while protecting consumer privacy? Should a federal agency provide for such a registry? What minimum information would be available to allow credit reporting agencies to include PACE

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<sup>14</sup> California enacted in AB 2063, Section 13 (2018) discretionary authority for the California Division of Business Organizations to require establishment of a “real-time registry or data base system for tracking PACE assessments...[which may include] features for providing or obtaining information about a property’s status with regard to PACE assessments placed on [a] property, whether recorded or not.”

obligations in credit reports obtained in connection with mortgage origination or servicing?

7. Should servicers of mortgage loans for the Enterprises provide an annual or more frequent notice to existing borrowers in PACE-eligible communities informing them that, under the terms of their mortgage, PACE liens are not permitted? Should borrowers be informed of the difficulties that may arise in selling or refinancing their home when a PACE lien has been placed on their property? What other information, if any, should be provided by servicers to borrowers with regard to PACE liens? Should borrowers in PACE jurisdictions be required to execute any additional agreements or certifications in connection with mortgages for the Enterprises, Home Loan Banks or FHA guaranteeing the borrowers will not accept PACE financing for energy efficiency improvements?

8. The Consumer Financial Protection Bureau published and received comment on an Advanced Notice of Proposed Rulemaking on disclosures under the Truth in Lending Act, as required by section 307 of the Economic Growth, Regulatory Relief and Consumer Protection Act, PL 115-174 (2018). The ANPR addresses, in line with the statute, TILA sections relating to ability to repay requirements and to application of civil money penalty provisions for TILA violations.

FHFA seeks input on matters beyond the scope of the statutory and regulatory provisions addressed by the CFPB. For example, do consumers face issues regarding the tax treatment of PACE loan payments and reporting to consumers of deductible versus non-deductible expenses? Are there consumer impacts from PACE liens on title searches? What impacts might arise where local governments use structures such as an

unelected Joint Powers Authority that limit government responsibility for PACE program administration? What options exist for a homeowner who can no longer afford to repay a PACE lien, such as a tax deferral by the taxing authority? What issues arise from the use of approved contractor lists and the impact on costs, contractor regulation, and recourse for consumers for defective equipment? What issues may arise from notification practices regarding PACE liens at time of property sales and other issues that align with or expand on consumer related concerns raised by the CFPB?

9. What information regarding experiences under programs of the Department of Housing and Urban Development relating to PACE may be relevant for consideration by FHFA in its evaluation of public input? Where PACE programs create super-priority liens, should loan products issued or guaranteed by the government, such as Federal Housing Administration mortgage insurance, consider adjustments such as risk based mortgage insurance premiums or limits on partial or assignment claims or the availability or terms of modifications allowable? Should government programs, such as those of FHA, contemplate further limiting the availability of mortgage insurance in PACE jurisdictions for forwards, HECMS or both? Are there improvements that government programs could undertake, such as FHA increasing utilization of its “green” insured mortgages or its Section 203(k) rehabilitation mortgage insurance program to avoid the risks associated with PACE programs?

#### *E. Responses*

FHFA invites responses on all aspects of this Request for input. Respondents should identify by number the question each of their comments addresses. Copies of all responses will be posted without change, including any personal information you

provide, such as your name and address, email address, and telephone number, on the FHFA website at <https://www.fhfa.gov>. Copies of all responses received will be available for examination by the public through the electronic docket for this Notice also located on the FHFA website.

In responding to these questions, respondents should provide their viewpoints as to the implications of such actions, the cost to business or to the public of such actions, benefits or risks in such actions, and specific terms or specific provisions that would be appropriate in undertaking such actions. FHFA also welcomes additional input on any issues raised in considering these questions or going beyond the questions asked. Responders need not reply to all questions set forth here. At the same time, respondents may suggest other actions that FHFA should consider and provide an explanation of the rationale and benefits of such action.

**Dated:** January 10, 2020.

**Mark A. Calabria,**

*Director, Federal Housing Finance Agency.*

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